CBO PAPERS

MANDATORY SPENDING CONTROL MECHANISMS

February 1996

CONGRESSIONAL BUDGET OFFICE

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SECOND AND D STREETS, S.W.
WASHINGTON, D.C. 20515

PREFACE

This Congressional Budget Office (CBO) paper analyzes methods of controlling mandatory spending through the budget process. It catalogs both the methods that are now in place and mechanisms that have been proposed in recent years. In the case of the proposed mechanisms, it also examines how well they might perform according to certain criteria. The paper was prepared in response to a request from the Subcommittee on Legislative and Budget Process of the House Committee on Rules.

Neal Masia of CBO's Special Studies Division wrote the paper under the direction of Robert Hartman and Marvin Phaup. James Blum, Gail Del Balzo, James Horney, Philip Joyce, Richard Kasten, Constance Rhind, and David Torregrosa offered helpful suggestions. Jeffrey Holland provided the data for Table 1. Leah Mazade edited the paper, and Christian Spoor proofread it. L. Rae Roy prepared the report for publication.

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February 1996

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The Congress has often enacted laws that entitle people, states, or other entities fulfilling certain eligibility requirements to receive payments or benefits from the federal government. (An example of such legislation is the Social Security Act of 1935, which authorized the Social Security program and was later amended to authorize the Medicare program.) In addition, other laws that do not technically establish entitlements nevertheless obligate the federal government to make specified mandatory payments. Spending of that nature is often referred to as mandatory spending because the law requires that the funds be made available. (Entitlements are a subset of mandatory spending.) In some cases, such as Social Security, payments take place without an annual appropriation; in other cases, such as Medicaid, the Congress by law must pass an appropriation bill. Spending that is not mandatory, such as spending for defense or for the Commerce Department, is usually called discretionary. The law does not require that funds for such programs be made available annually; however, most discretionary spending is provided for in 13 regular annual appropriation bills.

Over the past two decades, mandatory spending has been growing rapidly, both as an absolute amount and as a percentage of total spending. Federal spending for mandatory programs now accounts for about 12 percent of gross domestic product and over 54 percent of federal budget outlays. In recent years, policymakers have struggled to control such expenditures, but most observers believe that those efforts have fallen short. Although the Congress made (or proposed) significant cuts in mandatory programs in 1995 (as it did in the Omnibus Budget Reconciliation Acts of 1990 and 1993), the likelihood of continued high rates of growth has left many Members feeling frustrated. Therefore, legislators have also been considering changes in the way mandatory spending bills are considered in the legislative and budget processes.

Observers frequently note that it is difficult to link changes in the budget process with particular policy outcomes--the failure of the Balanced Budget and Emergency Deficit Control Act of 1985 (also known as Gramm-Rudman-Hollings) supports that observation. The budget process is much better at enforcing compliance with explicit changes in policy, as it has done under the Budget Enforcement Act of 1990, than at producing changes through indirect means. The attempt now under way to enact policies that would result in a balanced budget in seven years is an example of the former case, in which changes in policy precede changes in process. In fact, if the Congress implements the policies that it is now considering, the short-term search for mechanisms to control mandatory spending might end because the programs driving the large increases in that spending--Medicare and Medicaid--would exhibit lower rates of growth.

Yet in the light of past failures, many Members are concerned about the credibility, over the long term, of plans to balance the budget. As a result, they seek alternatives to ensure that spending will not increase in the future. Supporters of changes in the budget process contend that those changes can at least point policymakers in the direction of reducing spending and can help to frame politically sensitive issues in a way that might allow those issues to be considered in that context. Furthermore, proponents point out that well-designed process changes can introduce credible penalties for failing to act, which might encourage substantive legislative changes.

The Congress has several methods of controlling mandatory spending. Clearly, the most direct way is simply to change each underlying law that specifies who is to receive benefits and in what amounts. It is, however, politically burdensome to vote to cut previously enacted levels of spending. (In the extreme case, some mandatory programs--such as Social Security--cannot even be discussed without provoking controversy.) Tools now in place for controlling spending recognize that difficulty: for example, large deficit reduction packages (also known as reconciliation bills) combine cuts in spending with other measures, requiring legislators to vote the entire package up or down; and the pay-as-you-go process raises the prospect of an across-the-board sequestration (that is, a cancellation of budgetary resources) if new spending is not offset by tax increases or spending reductions.

The current Congress has tried to control spending directly by converting some mandatory programs into block grants to the states or by embedding fail-safe provisions in spending legislation. (Fail-safe provisions specify actions that shall occur in the event of unexpected increases in spending.) Because, however, the Congress has not controlled mandatory spending using the tools that are now available, reformers have proposed new methods of control with certain goals in mind. Among them are to ensure the desired result (for example, lower spending); to apply the cuts flexibly, when needed; to maintain accountability as a characteristic of the mechanism; and to keep the approach relatively simple. All proposals may be evaluated on their ability to meet those goals; in addition, other aspects must be considered (such as the mechanisms' potential effects on the social safety net).

Proposals under consideration in recent years include ending the mandatory status of all such programs, creating explicit caps on mandatory spending that are analogous to the caps on discretionary spending that are already in place, introducing targets for overall deficit reduction but with optional enforcement, and controlling spending by program area using automatic reductions when necessary. Most of the plans achieve some of the reformers' goals but not all of them. Some plans seem likely to control spending at the cost of reduced flexibility, whereas others are so flexible that nothing is assured. Some approaches look good in theory but would be so complicated that they could probably never be implemented; others are quite

simple but would take away part of the social safety net. Some systems would ensure cuts in spending by threatening to sequester funds from all programs regardless of whether spending in only some of those programs was too high, whereas others plan to penalize only the programs with funding shortfalls--which increases accountability in theory but raises doubts about execution. This paper catalogs the methods for controlling mandatory spending that are now in place and discusses recent proposals for new ones. It also analyzes how those mechanisms might be assessed.

MANDATORY SPENDING: HOW MUCH WILL IT GROW, AND WHY IS IT MANDATORY?

As noted earlier, mandatory spending, in both absolute dollar terms and as a percentage of total government spending, has been growing for years and is projected to continue to grow under current policies (see Table 1).[1] In dollar terms, total mandatory spending is projected to increase from $881 billion to $1.6 trillion over the 1996-2005 period; as a percentage of all federal spending, it is projected to grow from just over 55 percent in 1996 to about 64 percent in 2005. After debt service and offsetting receipts are taken into account, it becomes clear that the remainder of all federal spending--that is, discretionary spending--constitutes only a small (and, over the years, increasingly smaller) proportion of the total budget.

The Congressional Budget Office (CBO) distinguishes between means-tested programs (which provide cash, benefits that are equivalent to cash, or services to people who meet a test of need based on income, assets, or other criteria) and non-means-tested programs (which do not base eligibility on such a test). In 1996, non-means-tested programs make up over 77 percent of all mandatory spending; the two largest non-means-tested programs, Medicare and Social Security, represent nearly 62 percent of total mandatory spending. Medicaid, which requires recipients to satisfy a means test, is the third-largest mandatory program and accounts for more than 11 percent of all mandatory spending. By 2005, CBO projects that non-means-tested programs will decrease to about 74 percent of mandatory spending. Social Security and Medicare together are projected to remain at about 62 percent of mandatory spending, but Medicaid is projected to grow to over 14 percent.

Another useful way to view the growth of mandatory spending programs is to consider the rates of growth projected for their overall spending (see Table 2). From that perspective, Medicare and Medicaid are not only two of the largest programs, but they are also two of the programs that are projected to grow the fastest over the

1. Debt service and offsetting receipts are not included in this discussion. Legislation may affect offsetting receipts directly, but it affects debt service only indirectly.

TABLE 1. CBO BASELINE PROJECTIONS FOR MANDATORY SPENDING
(By fiscal year, in billions of dollars)

	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005
	Means-Tested Programs									
Medicaid	97	107	118	130	142	157	173	190	209	229
Food Stamps[a]	26	28	29	31	32	33	35	36	38	40
Supplemental Security Income	24	29	32	35	41	37	44	47	51	59
Family Support	18	18	19	19	20	20	21	22	23	23
Veterans' Pensions	3	3	3	3	3	3	3	3	3	3
Child Nutrition	8	8	9	10	10	11	11	12	12	13
Earned Income Credit	19	20	21	22	23	24	25	25	26	27
Student Loans[b]	2	2	2	2	3	3	3	3	3	3
Other	4	4	5	5	5	6	6	7	7	8
Total, Means-Tested Programs	201	220	238	256	279	294	32	345	371	405
	Non-Means-Tested Programs									
Social Security	349	367	386	405	425	447	469	493	518	545
Medicare	196	216	236	258	281	305	332	362	396	435
Subtotal	546	583	622	663	706	752	801	855	915	981
Other Retirement and Disability										
Federal civilian[c]	44	46	49	51	54	57	59	62	65	68
Military	28	29	31	33	34	35	37	38	40	41
Other	4	4	4	4	5	5	5	5	5	5
Subtotal	76	80	84	89	93	97	101	105	109	114
Unemployment Compensation	24	25	26	27	28	29	31	32	33	34
Other Programs										
Veterans' benefits[d]	17	19	19	20	22	23	23	24	25	26
Social services	6	6	6	6	6	6	6	6	6	6
Credit reform liquidating accounts	-4	-6	-7	-6	-6	-6	-6	-6	-6	-7
Other	15	18	19	21	20	21	21	20	20	20
Subtotal	34	36	37	40	41	44	44	44	45	46
Total, Non-Means-Tested Programs	680	724	769	819	868	922	977	1,036	1,102	1,175
	Total Mandatory Spending									
In Billions of Dollars	881	945	1,007	1,075	1,147	1,215	1,297	1,380	1,473	1,580
As a Percentage of Federal Spending	55.2	56.7	58.0	59.1	60.1	61.0	61.8	62.5	63.2	64.1
As a Percentage of GDP	12.0	12.3	12.5	12.7	12.9	13.0	13.2	13.4	13.7	13.9

SOURCE: Congressional Budget Office.

NOTES: Spending for major benefit programs shown in this table includes benefits only. Outlays for administrative costs of most benefit programs are classified as domestic discretionary spending; Medicare premium collections are classified as offsetting receipts.

Numbers may not add to totals because of rounding. GDP = gross domestic product.

a. Includes nutrition assistance to Puerto Rico.
b. Includes both direct and guaranteed loans.
c. Includes Civil Service, Foreign Service, Coast Guard, and other retirement programs, and annuitants' health benefits.
d. Includes veterans' compensation, readjustment benefits, life insurance, and housing programs.

TABLE 2. CBO BASELINE PROJECTIONS FOR THE PERCENTAGE INCREASE IN GROWTH RATES OF TOTAL SPENDING FOR MANDATORY PROGRAMS

Program	1996-2000	1995-2005
Supplemental Security Income	71	146
Medicaid	46	136
Medicare	43	122
Child Nutrition	25	63
Social Security	22	56
Federal Civilian Retirement[a]	23	55
Food Stamps[b]	23	54
Veterans' Benefits[c]	29	53
Student Loans[d]	50	50
Military Retirement	21	46
Earned Income Credit	21	42
Family Support	11	28
Veterans' Pensions	0	0
Social Services	0	0

SOURCE: Congressional Budget Office.

a. Includes Civil Service, Foreign Service, Coast Guard, and other retirement programs, and annuitants' health benefits.
b. Includes nutrition assistance to Puerto Rico.
c. Includes veterans' compensation, readjustment benefits, life insurance, and housing programs.
d. Includes both direct and guaranteed loans.

next five to 10 years. Social Security is expected to grow moderately over the next 10 years, but that growth will accelerate after the 10-year window, when the baby boomers begin to retire. Welfare programs other than Medicaid constitute a relatively small share of the budget and, with the exception of Supplemental Security Income, are not projected to grow very fast.[2]

Several explanations can be put forward for why Social Security, Medicare, and Medicaid make up such a large percentage of present and future total mandatory spending. One is the scope of the programs: most legal residents over age 65 are eligible to receive benefits under Social Security and Medicare, regardless of their level of income. Demographic shifts, such as increased life expectancies, have also contributed to continued and projected growth. Other reasons for high levels of spending and projected rates of growth in Medicare are increased health care consumption by the eligible population and inflation in the medical care industry, which is high relative to overall increases in prices. Moreover, benefits under Social

2. Total spending for the Supplemental Security Income programs is still projected to be much lower than spending for Medicare or Social Security.

Security and other retirement programs depend not only on inflation and demographic changes but on real wages (that is, wages adjusted for inflation)--the increase in real wages that analysts expect in future years implies higher levels of benefits in the future.

Policymakers have aimed their recent budget-cutting efforts at Medicare and Medicaid in particular, because they are such big targets. In the case of Medicare, a perceived threat of insolvency in the system has fueled those activities. In contrast, Social Security has been placed "off the table" in current budget negotiations. Other attempts to control mandatory spending have focused on welfare, which usually denotes means-tested programs. For example, some lawmakers have advocated repealing those programs in favor of block grants to states (see the later discussion).[3] The choice of a specific control method will depend in part on what role legislators envision for mandatory programs. It therefore seems worthwhile to examine the reasoning behind the existence of mandatory programs as well as the problems critics contend those programs cause.

What Are the Advantages of Mandatory Spending Programs?

Mandatory spending programs provide benefits to a broad range of people. Although each individual entitlement or mandatory program has been designed to achieve a particular set of goals, it is possible to distinguish broadly between two main purposes of many of the programs: acting as a social "safety net" and enhancing people's ability to plan for the longer term. (That categorization is not exhaustive, but most mandatory programs are intended to serve at least one of those purposes and some serve both.) The distinction is useful because attempts to control mandatory spending through the budget process might have different effects on the ability of such programs to serve the broad purposes for which they were intended.

Social Safety Net. Many taxpayers and policymakers believe that society should ensure a minimum standard of living for the U.S. population. In this century, government has come to play a large role in providing that minimum level of subsistence. According to proponents of spending for mandatory programs, that function becomes especially important when the U.S. standard of living is threatened by economic downturns or other unavoidable events. Advocates argue that programs such as Medicaid, Aid to Families with Dependent Children (AFDC), and Food Stamps are a social safety net, providing some people with subsistence and the means to cope with medical or financial emergencies. In hard economic times, mandatory

3. Other CBO publications, such as the annual deficit reduction volume, present options for cutting spending through particular programmatic changes such as changing the retirement age, reducing or eliminating cost-of-living adjustments, means-testing more programs, or establishing work requirements for welfare recipients.

spending programs can act as automatic stabilizers, arresting declines in income that might otherwise plunge families and individuals into extreme poverty.

Longer-Term Planning. Some mandatory programs, most notably Medicare and Social Security, provide benefits to recipients regardless of their current income.[4] Medicare and Social Security are two of the federal government's most staunchly defended programs; indeed, Social Security is usually excluded from discussions about controlling mandatory spending and is afforded special treatment in the budget. The broad support for these programs probably stems in part from the fact that people who do not currently receive benefits will eventually be entitled to them. Aside from the redistributional component of the programs, many taxpayers view them as part of their personal insurance and retirement plans. Proponents argue that it is in that sense that mandatory programs serve their second main purpose: as an aid or supplement to midrange and long-term financial planning. Even if the programs were originally intended only as a safety net, people now view their benefits as personal assets that they expect to receive in the future. In some cases, it is the only form of insurance in which they participate.

Many observers claim that programs such as Social Security and Medicare benefit society as well as individuals by improving the long-term manageability of retirement planning. With a well-planned retirement, many taxpayers can avoid using the short-term safety net as a long-term solution when their wage-earning days are behind them. Thus, proponents maintain that the programs provide not only personal but social insurance: they reduce the likelihood of beneficiaries' becoming a burden on society by forcing future recipients to contribute to social insurance while they are working.

What Are the Objections to Mandatory Spending?

Mandatory spending programs have critics as well as supporters. Some of those opponents worry that the structure of the programs leads to inevitably high rates of growth. Others contend that many of the programs offer the wrong incentives to recipients or ensure that the government plays an unacceptably large role in the lives of taxpayers.

Rapid Spending Growth. The fundamental objection that most critics have to the current system of mandatory spending is that there is no explicit budget constraint on most of the programs. Instead, spending rises or falls according to economic

4. To the extent that the benefits are subject to taxation (as is the case with some Social Security benefits and most federal employee pensions), the value of after-tax benefits can depend on a recipient's current income; however, eligibility for benefits does not.

fluctuations, program participation rates, the behavior of individual states, and demographic shifts. Furthermore, spending for two of the largest programs, Medicare and Medicaid, depends on increases in the price of medical care, which have recently been quite large and are fueled by advances in medical technology and the behavior of medical care providers.

Without changes in the laws governing mandatory programs, the high rates of spending for them will probably continue indefinitely. Many policymakers worry about the open-endedness that statement implies, which is one reason they have been looking for ways to set limits on spending. The Congress has also been considering wholesale changes to the programs themselves--for example, one proposal that has received much attention is to transform some welfare programs (in particular, Medicaid) into block grants to individual states. The idea behind that approach is to limit federal funds for the programs and let the states grapple with unexpected increases in prices, with utilization rates for some kinds of care that are higher than anticipated, and with other such changes.

Incentive Problems. Criticisms of mandatory spending programs are usually couched in terms of improvements to their incentive structure or their overall scope. Some critics contend that the programs themselves may provide incentives that encourage the type of behavior that created a need for the programs in the first place. Those critics rarely support abolishing all social safety net programs; rather, their objections relate to which contingencies the government ought to address.

A related problem that some people have with government insurance programs is the way they affect beneficiaries' planning. Although a social safety net is intended to fill gaps in income that might arise from events that are beyond a person's control, mandatory spending programs create incentives for future recipients to intentionally plan for gaps (that they know will be filled by government benefits) over the middle and long terms. For example, the amount of money many workers save for retirement depends on their expectations about future benefits, and the amount of health insurance they purchase in later years depends on what they think they will receive in Medicare benefits.

The Proper Role of Government. Some programs that are intended to help people plan for the long term provide assistance to recipients who would not be excessively burdened by the loss of some (or even in some cases, all) of their benefits. Some people take issue with the government's large role in income redistribution in this country and question why the government transfers wealth (in the form of benefits) to recipients who do not need it. Such critics usually point to open-ended mandatory programs as an example of the government's overstepping its appropriate role in the lives of residents. One approach that has been frequently proposed to resolve this

issue is to means-test a wide range of benefits, thereby reducing the overall scope of government payments and activities.

MECHANISMS NOW IN PLACE FOR CONTROLLING MANDATORY SPENDING

The Congress currently has several ways it can limit mandatory spending; the most important are the rules for budget resolutions and reconciliation established by the Congressional Budget and Impoundment Control Act of 1974 and the pay-as-you-go (PAYGO) process set up in the Budget Enforcement Act of 1990. In addition, some people believe that certain methods of treating mandatory spending legislation can act as controls. Two examples are block grants and fail-safe provisions.

Reconciliation

Reconciliation was included as part of the 1974 act, but it was not used in its current broad form until the early 1980s. In the reconciliation process, the Congress considers a number of changes in mandatory spending programs and revenues at one time, in large omnibus measures. The committees responsible for the spending programs are directed by the Congress's concurrent resolution on the budget to recommend changes to the law that will result in a certain amount of projected spending or revenue. The process is optional, but it has been used with increased frequency in recent years. Usually, the group of reforms is presented as a deficit reduction measure and is voted on under restrictive rules in both Houses of Congress. Packaging the reforms into an omnibus proposal is crucial: although cuts to individual programs might be defeated on a case-by-case basis, considering them together (in an up-or-down vote) increases the chances of their being passed. (Legislators can correctly claim that they have voted for deficit reduction, thus mitigating the political cost of their vote by appealing to a sense of shared sacrifice.)

PAYGO Rules and Sequestration

The Balanced Budget and Emergency Deficit Control Act of 1985 (the Balanced Budget Act) introduced the idea of sequestration into the budget process. The Balanced Budget Act established deficit targets for each year through 1991. If the Congress did not meet one of the targets, a sequestration would be triggered; that is, across-the-board reductions would be made automatically in both mandatory and discretionary spending. The idea behind the mechanism was that the Congress would ensure that the deficit reduction targets were met to avoid the unpleasant alternative of across-the-board reductions in programs. Some programs were protected from the

sequestration; in particular, many mandatory programs were either excluded from cuts or the cuts were severely limited. As a result, discretionary programs were exposed to potentially large-scale reductions. By 1990, however, the targets had been rendered meaningless, and in 1993 they were not extended. The failure of the Balanced Budget Act to control spending and reduce the deficit led to the consideration of alternative mechanisms.

The Congress carried over the basic idea of sequestration as an enforcement mechanism to its next reform, the Budget Enforcement Act of 1990 (BEA). The act eliminated fixed deficit reduction targets as a restraint and instead set out pay-as-you-go rules for the budget process. The new rules basically required that the projected net effect of all mandatory spending and revenue legislation enacted in a fiscal year be deficit neutral within that year and for five subsequent fiscal years; that requirement was (and still is) enforced by a sequestration mechanism. CBO and the Office of Management and Budget keep track of all new direct spending and revenue legislation on a scorecard, and if the scorecard shows a projected net addition to the deficit at the end of the budget cycle, a sequestration eliminates the increased spending. In concentrating only on the effects of new legislation, the BEA has a much narrower focus than the Balanced Budget Act. Some people cite that difference as the reason for the relative success of the BEA.

The two types of sequestration mechanisms differ in several ways. First, under the BEA, the amount to be sequestered is limited to the amount that is added to the deficit on the PAYGO scorecard--rather than some predetermined overall deficit reduction target such as those found in the Balanced Budget Act. Second, under the BEA but not under the Balanced Budget Act, increases in mandatory spending programs under current law cannot trigger a PAYGO sequestration, although those programs would still be cut if a sequestration was triggered by new legislation. Third, and perhaps most important, PAYGO rules hold the Congress harmless for changes in economic conditions and other factors that affect the baseline (the benchmark for measuring the budgetary effects of proposed changes in federal revenues or spending). Unlike the Balanced Budget Act, the BEA requires only that new legislation be projected to be deficit neutral for each fiscal year. It guarantees neither a total maximum level of mandatory spending nor that the new legislation will actually be deficit neutral in the end. Rather, the PAYGO rules guarantee that projected spending and revenues under new legislation will add up to zero on a deficit scorecard or a sequestration will be triggered to cut spending. What the two mechanisms have in common is that they were both intended to provide incentives for the Congress to hold down spending increases and to enforce a particular decision about the level of spending control--whether that decision be to control only new legislation or the deficit overall.

Block Grants

The 104th Congress has been particularly interested in changing means-tested programs that are currently administered, in whole or in part, by the states. That group of mandatory spending programs, which includes Medicaid and AFDC, makes up a large part of what is commonly thought of as welfare. Today, most federal funding for those programs takes the form of matching grants to states, and the matching rate (the amount that the federal government contributes for each dollar the state contributes) depends inversely on per capita state income. States generally have some latitude in setting eligibility standards and benefit levels, subject to certain minimum program characteristics that are necessary to qualify for federal funds. Many (but not all) block-grant proposals would use the current levels of funding for each state as a baseline, and simply require that the level of federal funds to be spent by each state in future years be determined by adjusting the current level for inflation or other changes. Other block-grant proposals would go farther and eliminate the mandatory aspect of the spending, requiring that new funds be voted on and distributed to states on a regular basis. Most welfare programs would be repealed, leaving states with much broader latitude to determine how to distribute funds among their programs. Proponents believe this approach would effectively limit spending for mandatory programs; critics question the long-run viability of vesting states with greater responsibility for the programs.

Fail-Safe Mechanisms

Fail-safe provisions are included in legislation to specify contingency plans for particular programs in the event that spending is higher than originally anticipated. (The approach is a fallback provision that specifies precisely how, if necessary, spending is to be cut.) The detailed nature of many fail-safe mechanisms often contributes to the contentiousness surrounding consideration of what are generally complex bills, but proponents believe that their inclusion ensures that spending will be controlled. However, many policymakers doubt that the provisions would be faithfully executed if they were invoked to reduce spending.

RECENTLY PROPOSED CONTROL MECHANISMS

Detailed below are specific proposals for additional mechanisms to control mandatory spending that have been introduced as legislation in the 103rd and 104th Congresses. It is worth reiterating that all of those mechanisms are ways of changing either laws, benefit levels, or other program characteristics when the Congress does not make those changes directly in stand-alone legislation or when the changes that it does make are judged insufficient. Of course, the Congress may change the